

**HOWREY & SIMON**

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August 4, 1982

Timothy P. Reames  
Vice President - General Counsel  
Mattel, Inc.  
5150 Rosecrans Avenue  
Hawthorne, California 90250

Confidential

Dear Tim:

Your secretary has confirmed the reservation for me at the Four Seasons for the nights of August 17 and 18 and I have confirmed a meeting with Dave Newman at 1:30 p.m. on August 18. I will be flying in on the evening of August 17.

I have reviewed each of the documents which you left with me in detail and I am returning your copy with this letter.

As you know, the Federal Trade Commission for many years before the recent amendments to the FTC Act, has taken the position that restitution may be available to parties damaged as a result of deception by a vendor. Where a vendor advertises representations with regard to a product or a tied product, a responsibility to the purchaser occurs. There may be certain defences such as the financial failure of the vendor and inability to follow through, the true value of the original is charged the customer with no substantial increase in the purchase price being incurred as a result of the value of the promised future product, or the lack of any substantial profit to the vendor.

The FTC has taken the position for a number of years, when false representations have been made to induce a customer to buy, that the refusal to return money or property to consumers may be an unfair trade practice. One of the questions that has arisen in the past is whether the sale is "complete" until all commitments in the offer by the vendor have been tendered to the purchaser.

The FTC's enforcement efforts regarding representations as to the availability of future benefits in the last several years has been concentrated in its land fraud cases. It brought a number of actions, most of which have been settled against land promoters who sold lots representing that they would make available utilities, roads, clubhouses, etc. within a period of time after

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the sale and, most importantly, that the lots that the developers were offering for sale would appreciate in value and was a good financial investment. In a number of these cases the Commission has forced the developers to reduce the price to the purchaser, give the purchaser an opportunity to cancel the contract, or require the developer to comply with its premises to provide future benefits. In the Las Animas Ranch case, for example, the consumer redress included notifying the purchasers that they could receive a refund or a price reduction.

In another recent case the FTC has charged that a video game franchisor defrauded customers by failing to provide promised machines and services within the time promised. In that case the FTC is not only seeking injunctive relief against the charged practices but also restitution against consumer losses.

In assessing the substantiality of deceptive advertising, the FTC looks to the number of ads, the scope of the distribution and the amount of advertising dollars spent. It also looks to the interpretation that consumers may place on the representations made. In this connection, you must evaluate the extent to which the challenged advertising would influence the purchase decisions of consumers, the number of consumers that might have been affected, and the amount paid by the consumers in reliance upon the representations. One of the questions asked is whether the consumer would have purchased the product in any event, except for the representation in question. Or in this case, did the consumer pay a higher price in anticipation that the representations with regard to the keyboard computer would be honored. In short, can economic damage to the consumer be attributed to the consumer's reliance upon the representation. If the product is an expensive item or if it is purchased frequently, the likelihood that the FTC will assume damage to the consumer is much greater.

Although an advertising scheme may be deceptive, it is arguable that no case should be brought where few consumers were enticed to buy because of the advertising and, in any event, there is no need for significant relief because the practice has been permanently discontinued. Additional considerations include the volume of sales of the advertised product, the cost of the advertising, the ratio of the advertising expense to sales revenues, the substantiality of the advertising, etc.

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There are three basic charges which may be made by the Federal Trade Commission here. The first and most important, of course, has to do with the continued advertising of the availability of a keyboard computer in the near future after it becomes questionable that it will ever be available. It may also consider the advertising of cassettes for the keyboard computer and tapes for the master component which were delayed or never made available. It may be argued that these delays or failures to produce are part of Mattel's policy or strategy, and over the period of time that the representations were made in advertising, Mattel had not made a commitment to provide the keyboard computer or certain of the cassettes and tapes which had been announced.

Although it is not clear to me what distribution some of the advertising material received, it does appear that the amount of advertising that reached the consumer was sufficient for a claim by the FTC that a purchaser of the master component could rely on the representation that he would have the opportunity of purchasing the keyboard within a reasonable time. Beginning as early as December of 1979, press releases and other advertising and promotional materials stated that the keyboard computer was expected to be available in mid-1980 with four cassettes and that four additional cassettes would be introduced later in 1980. By June of 1980, advertising materials announced that the Intelelevision keyboard would be available in 1981. In February a demonstration of the capabilities of the component was given at Macy's with an announcement that it would be available in the summer.

It is not clear from the file to what extent the advertising was consumer oriented versus trade oriented via press releases and brochures. It does appear, however, that consumers were repeatedly informed in both television and print advertising that the keyboard and cassettes would be available in a reasonably short time. An analysis of the consumer complaints suggest that a number of consumers relied upon representations in consumer advertising which induced them to purchase Intelelevision in preference to Atari or one of the other competitive programs believing that the keyboard computer would shortly be available. In fact, in Mattel's annual report for the year ended January 30, 1982, it was announced that during fiscal 1982 Mattel introduced its keyboard computer into two test markets and that plans call for expanded distribution of the keyboard computer in additional markets during the upcoming year.

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In preparation for our meeting with the Federal Trade Commission, it would be helpful to have someone give us answers to the questions set forth below. Indeed, it is advisable that we set up a conference call next week with the individual or individuals who would be most knowledgeable on the subject matters discussed herein.

- (1) Were the consumers induced to buy the master component because of the representations with regard to the keyboard computer? In answering this question we need to determine whether the price we charged for the master component included any markup relating to the tie-in to the keyboard computer. Noting that a number of the complaining consumers compared the price of Atari and other sets such as Odyssey and Sears as being much lower priced, there is a suggestion that the higher price received by Mattel may have been realized, in part, because the customer anticipated the forthcoming keyboard component. Would our price have been the same if we had not offered the keyboard? Is the profit on the master component so great that the FTC could assume there was a built-in charge for the future keyboard computer? How much more did the consumer pay for the master component than it would have paid if Mattel had not invested in research, development and test marketing, etc. of the keyboard computer?

7

no

~~yes~~

not during the time  
and were advertising  
cost reductions are in  
process + personnel  
be reduced.

none

- (2) What is the overall policy and strategy of Mattel with regard to advertising any of its products prior to the time that they have been perfected and are ready for marketing? Trace the Mattel policy and strategy as it relates to the keyboard computer. When did we first decide to build a keyboard computer? What efforts went into the research and development and into expediting the development of this component? Is it Mattel's policy to announce the future introduction of a product before it is substantially developed? Does that policy permit scrapping of such introductions after

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? they have been repeatedly advertised to the public? Was the shortage of the announced tapes for the master component related to a policy which permitted a failure to introduce the keyboard computer nationally and a failure to perfect the eight cassettes for the keyboard computer?

- Reasons for discontinuing (hopefully inform consumers circumstances)*
- (3) Develop the efforts that were involved in trying to solve the research and development problems of the keyboard computer. What accounts for our failure? How much money was put into the project? When was it first decided that the keyboard computer might be dropped? Why did we continue to represent to the consumers that it would be marketed after this tentative decision? Can we gain any advantage by detailing the facts surrounding the early development of the keyboard computer by a major supplier who backed out of the deal and the necessity of going to a smaller supplier who could never produce a quality product?

- no*
- that I add with no software*
- (4) What did we learn from the 25 keyboard computers test marketed in Fresno? Did this test fail? If so, why did we continue? Why was the test marketing of the keyboard computer on a substantial basis delayed until early 1982? Was the Seattle and Denver test marketing considered a success or a failure? Did problems come to light in those two markets that led the company to conclude that the keyboard computer was not of adequate quality, was overpriced, or that there were other problems that required its withdrawal? It is my understanding that we sold 1,200 to 1,400 of the keyboard computers in these test markets. Are these the sales to distributors or consumers? Did we have to take back any of these computers? Do we have a reasonable estimate of the number of these computers that were purchased by competitors or potential competitors? Were the consumers who purchased these satisfied with their purchase? Did we have the potential to sell these
- \* Let return numbers*  
*\* consumer satisfaction*
- check*

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components profitably on a nationwide basis at a 40% margin with a retail price of \$500-600?

- (5) Was a premium price paid for the master component? Did the consumer get value for his dollar? Was the Mattel master component worth the difference between its price and the price of the Atari? *no yes yes*
- (6) The sales of the master component increased very substantially between 1980 and 1982. Did this demand for increased sales and the shortage of production cause the company to ignore the commitment to produce and market the keyboard computer as scheduled? Are there any estimates as to what percentage of the master component purchasers would have purchased the keyboard computer? *not directly, at least, unless, 25%, I think*
- (7) We had about 50 complaints in 1980. It is estimated that the complaints in 1981 would be approximately 100. What are the ratio of these complaints to the sales of the master component in a comparable period?
- (8) Have we stopped all advertising of the keyboard computer? When did we stop? Why did we stop? Had we decided to introduce the new keyboard before or after we determined to stop advertising or selling the original keyboard computer? Why did we switch to a scaled down model? Since the new keyboard computer does not have the keyboard and is not designed to perform many of the functions which the original keyboard computer was designed to perform, can it be argued that the new keyboard computer satisfies the representations made in the advertising of the original keyboard computer? *yes cost sketch the imagination*

Analyzing the material under Tab 2, it appears that the Federal Trade Commission has asked for additional complaints. I would suggest that we gather these complaints and analyze them for our own purposes, but that we hold off on any decision to

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turn them over to the FTC until after our meeting. It is my understanding that the information under Tab 2 has not been made available to the Federal Trade Commission. I suggest that we both review this material over the next several days and discuss this in our conference call next week.

After you have had an opportunity to read this letter, it would be helpful to me if we could discuss it prior to the discussion which I have suggested for a conference call next week.

Very truly yours,

  
J. Wallace Adair, P.C.

Enclosure